

Letter of Findings Number: 08-0255
Income Tax
For Tax Years 2004-06

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ISSUE

I. Income Tax—Individual.

Authority: IC § 6-8.1-5-1; IC § 6-8.1-5-4.

Taxpayer protests the reduction of net operating losses for individual income tax.

STATEMENT OF FACTS

Taxpayer is an individual who operated a business out of his residence as a sole proprietorship. Since the business was a sole proprietorship, the business income flowed through to Taxpayer's individual return. As the result of an investigation, the Indiana Department of Revenue ("Department") determined that Taxpayer had claimed some items as business expenses which were not eligible for exemption or deduction. The Department made adjustments to add these items back to Taxpayer's income for the tax years 2004, 2005, and 2006. Since Taxpayer had net operating losses ("NOLs") available for all three years, the Department's adjustments resulted in a reduction of the NOLs available for future years. Taxpayer protested the Department's adjustments, claiming that the items were eligible for exemption or deduction as originally claimed. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Income Tax—Individual.

DISCUSSION

Taxpayer protests the Department's determination to reduce NOLs for the tax years 2004, 2005, and 2006. The Department conducted an investigation and determined that several items claimed as business expenses were not eligible for exemption or deduction. Taxpayer believes that several of the Department's adjustments were on items which were eligible for deduction or exemption. The Department notes that the burden of proving the proposed adjustments wrong rests with Taxpayer, as provided by IC § 6-8.1-5-1(c).

The Department refers to IC § 6-8.1-5-4, which states:

(a) Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

(b) A person must retain the books and records described in subsection (a), and any state or federal tax return that the person has filed:

- (1) for an unlimited period, if the person fails to file a return or receives notice from the department that the person has filed a suspected fraudulent return, or an unsigned or substantially blank return; or
- (2) in all other cases, for a period of at least three (3) years after the date the final payment of the particular tax liability was due, unless after an audit, the department consents to earlier destruction. In addition, if the limitation on assessments provided in section 2 of this chapter is extended beyond three (3) years for a particular tax liability, the person must retain the books and records until the assessment period is over.

(c) A person must allow inspection of the books and records and returns by the department or its authorized agents at all reasonable times.

(d) A person must, on request by the department, furnish a copy of any federal returns that he has filed.

The Department made its adjustments based on the documentation provided by Taxpayer. This documentation did not separate business expenses from private expenses in all instances.

The first item Taxpayer protests is a \$2,700 adjustment which the Department made to 2006 income on Taxpayer's return. The Department determined that this amount should have been included as income and reduced Taxpayer's NOL for 2006 by that amount. In the course of the protest process, Taxpayer provided explanation of what the \$2,700 was and showed that it had already been included in taxable income. Therefore, it was not necessary for the Department to add that amount again. Taxpayer has met the burden imposed by IC § 6-8.1-5-1(c) for this item.

Taxpayer's next item of protest is the Department's determination to disallow the claimed exemption on trash collection. The Department did not find sufficient documentation to separate Taxpayer's residential use of the trash collection from the business use of the trash collection. Since the business was operated out of Taxpayer's residence, the Department added an amount equal to standard residential trash collection fees in Taxpayer's geographic area to Taxpayer's income for all three years.

In the course of the protest process Taxpayer provided documentation showing that it had a commercial

trash pickup service for the years in question. While this does support Taxpayer's position, it does not explain what percentage of the service was used for business purposes and what percentage was used for personal purposes. Since the investigation, the Department has learned of an Internal Revenue Service audit which allowed ten (10) percent of trash pickup costs as business expenses. The Department will follow the federal determination and will allow ten percent of trash pickup expenses as business-related.

Taxpayer's final point of protest is the Department's determination that Taxpayer did not provide sufficient documentation to establish the business and personal percentages of car and truck expenses during this time period. Taxpayer protests that the truck was used almost exclusively for business purposes. Taxpayer states that he used two other vehicles for personal purposes. Taxpayer provided documentation supporting the position that he owned three vehicles. Upon review, the documentation does show that there were three vehicles, but does not establish what percentages each vehicle was used for business and personal purposes. As explained in the investigation report, the Department applied an exempt use percentage to all of Taxpayer's vehicle expenses, without separating each vehicle's particular use or exemption. The documentation provided in this protest does not meet the burden imposed by IC § 6-8.1-5-1(c).

In conclusion, Taxpayer is sustained regarding the \$2,700 which the Department had added as taxable income in 2006. Taxpayer is partially sustained regarding the trash pickup services for all three years. As determined by IRS audit, ten percent of the trash pickup services will be considered business expenses. Taxpayer is denied regarding vehicle expenses. There is insufficient documentation to establish personal use and business use of the vehicles. The Department will make the adjustments related to the items upon which Taxpayer has been sustained and will therefore increase the NOLs accordingly.

FINDING

Taxpayer's protest is sustained in part and denied in part.

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